Remarks as Prepared for Delivery

Edward J. DeMarco
Acting Director
Federal Housing Finance Agency

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An Update on the Conservatorships of Fannie Mae and Freddie Mac: Remarks at the MBA's 100th Annual Convention and Expo

Thank you for inviting me to speak this morning. I would like to start by congratulating the Mortgage Bankers Association on this 100th annual convention. That is quite a history, one that traces from a much different and more limited, housing finance system to one that creates far greater access to credit but that is recovering from a nationwide trauma in housing.

The good news is that the recovery is taking hold. The opportunity for rebuilding our housing finance system to a stronger, more competitive, and more resilient market is before us. Yet challenges are all around us. Implementing an array of new mortgage rules, many developed in response to the recent market and regulatory failures, creates uncertainty as to cost and impact. And we have an opportunity to rebuild the secondary mortgage market, but the political and policy challenges of that legislation are numerous.

Over the past five years in which Fannie Mae and Freddie Mac, or the Enterprises as I will refer to them, have been in conservatorships, much has been accomplished. The Nation's secondary mortgage market has continued to function. The Enterprises' financial positions have stabilized. We have made significant progress resolving the pre-conservatorship book of business. The Enterprises have played an important role in providing foreclosure prevention and refinancing options to borrowers. And through the Federal Housing Finance Agency (FHFA) Strategic Plan for Enterprise Conservatorships (Strategic Plan), we have begun the process of building for a future housing finance system.

However, even with those accomplishments, much remains to be done. The single-family mortgage market remains heavily supported by taxpayers. While there is progress on the legislative front, the timing of broader housing finance reform remains uncertain.

Authority and Responsibilities of FHFA as Conservator

In 2008, the immediate objective or initial phase of the conservatorships was to stabilize the Enterprises' operations and ensure that the secondary mortgage market continued to function.

As markets stabilized, the second phase of the conservatorships focused on developing tools to assist troubled homeowners while reducing credit losses.

The next phase is determining our responsibility to direct the conservatorships going forward. The law establishes the appointment of a conservator or receiver of the Enterprises "for the purpose of reorganizing, rehabilitating, or winding up the affairs of a regulated entity."[1] In fact, we are doing all three of these things – reorganizing, rehabilitating, and winding up the affairs of Fannie Mae and Freddie Mac. This is exactly the path we set forth last year when FHFA issued its Strategic Plan.

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[1] Housing and Economic Recovery Act of 2008, Section 1367 (a)(2), amending the Federal Housing Enterprises Financial Safety and Soundness Act, 12 USC 4617(a)(2).

More specifically, FHFA set forth three broad goals in the Strategic Plan:

1. **Build.** Build a new infrastructure for the secondary mortgage market.

2. **Contract.** Gradually contract the Enterprises' dominant presence in the marketplace while simplifying and shrinking their operations.

3. **Maintain.** Maintain foreclosure prevention activities and credit availability for new and refinanced mortgages.

We identified specific activities to achieve these goals in a Conservator's Scorecard in 2012 and 2013 and much progress on those goals has been achieved.

But as time moves on, the scale of the Enterprises' operations in conservatorship cannot remain static. As of December 31, 2012, the amount of taxpayer capital available to support the Enterprises' outstanding debt and mortgage-backed securities (MBS) obligations is fixed. Limiting risk exposure is vital to maintaining the adequacy of the remaining capital support through the U.S. Department of the Treasury support agreements.

The Next Phase of Conservatorship

What seems clear is that Fannie Mae and Freddie Mac will cease to operate in their current corporate form at some future date – a date to be set by Congress. FHFA's conservatorship Strategic Plan is designed to prepare the companies and the market for that date, while maintaining market stability and liquidity from now to then. The Strategic Plan aims to move forward with a transition to a post-conservatorship market, thereby making the final transition from the conservatorships as simple and quick to execute as possible.

To more clearly define this process, FHFA will soon establish multi-year targets for Fannie Mae and Freddie Mac to further achieve the three strategic goals of building for the future, contracting the footprint, and maintaining market liquidity and borrower assistance. In this next phase of conservatorship, we intend to build upon the accomplishments of the past two years while accelerating progress towards achieving each strategic goal.

I provided some thoughts on each line of the Enterprises' business last week. Today in my limited time I will focus on the Enterprises' single-family guarantee business.

With an uncertain future and a general desire for private capital to re-enter the market, the overarching goal is that the Enterprises' market presence should be reduced gradually over time. We have three main tools to accomplish this objective.

First, risk-sharing transactions are important for reducing the taxpayers' long-term risk exposure. We set a 2013 Scorecard target for each Enterprise to achieve $30 billion in risk-sharing transactions using multiple types of structures. Both Enterprises are on track to meet this target, and the transactions completed to date have been well received by the market. We are planning for the scope and depth of risk-sharing transactions to continue to expand.

While these transactions and structures are very positive, they do rely on the underlying infrastructure of the Enterprises. Going forward, I expect to see work done on other types of transactions such as senior/subordinated structures for certain portions of the Enterprises' mortgage guarantees. These alternative approaches will contribute to our efforts to build for the future by helping to develop a securitization infrastructure that is less reliant on the Enterprises' traditional government-sponsored enterprise securitization model.

Second, guarantee fees are about double what they were prior to conservatorship. A key reason to increase guarantee fees is to bring the pricing for credit risk closer to what would be required by private sector providers. While that level is difficult to evaluate with precision, I believe we are getting closer to a level that would encourage more private sector participation, and we plan to continue pursuing gradual guarantee fee increases in the near future.

Third, one of the most direct ways to increase private sector participation and reduce taxpayer exposure is through a reduction in the maximum size of loans that the Enterprises guarantee. This summer the President specifically endorsed a gradual reduction in maximum loan size. Since then there has been much discussion about a near-term reduction in the loan limits.

As you also probably know, last week I made clear that I understood the potential timing issues associated with such a change given the other regulatory changes that are scheduled to take place in the mortgage market. As a result, I said that FHFA will follow its practice of announcing the 2014 conforming loan limits in late November, at which time further information will be provided on potential reductions in the size of loans the Enterprises will guarantee going forward.

To provide further clarity, FHFA will give market participants at least six months' notice of any change. Any reduction would be across the board, not just in some parts of the country. And, consistent with our practice when increasing guarantee fees, any change would be measured and gradual so as not to disrupt markets.

While these steps are important and necessary to carry out our conservatorship responsibilities, our efforts also are focused on building towards a future infrastructure to support the single-family mortgage market. FHFA is looking to reposition the Enterprises' activities in ways that would support the various housing finance reform options pending in Congress.

One of those efforts is the Common Securitization Platform with the focus on functions that are routinely repeated across the secondary mortgage market, such as issuing securities, providing disclosures, paying investors, and disseminating data. These are all functions where standardization could have clear benefits to market participants. We recently announced the formation of Common Securitization Solutions as an equally-owned subsidiary of Fannie Mae and Freddie Mac. This new entity, which will have its own independent location and leadership, will manage the development of the platform and the associated data and legal infrastructure for future securitizations.

Next year, a key objective for us will be to formalize a means for MBA members and other market participants to participate in the development process of the common securitization platform. I am committed to ensuring broad industry input into this effort. I am also committed to an outcome that strengthens, not weakens, the ability of small and mid-sized lenders to access the secondary mortgage market. FHFA wants to see a competitive marketplace. Competition, and thus consumer opportunities, is enhanced when large lenders and small effectively compete in offering mortgages to families and compete in servicing those mortgages. But to get there, we must be willing to envision the mortgage market working differently than it has in the past.

Another example of where change is needed is in the putback risk loan originators face when selling mortgages. The business practices of the past must be improved in this area.

As purchasers and guarantors of mortgages, representations and warranties, or reps and warrants, have long served as a key risk control mechanism for Fannie Mae and Freddie Mac to ensure loans sold to them meet the requirements set forth in their seller guides.

Reps and warrants attracted less attention when times were good. The tremendous breakdown in loan origination quality during the boom period of the last decade led to unprecedented delinquencies, which has led to unprecedented loan reviews and putbacks. As conservator, FHFA believes that enforcement of long-standing contractual requirements was a necessary, albeit painful, process to protect taxpayers and assign losses where a contractual obligation exists.

This experience also demonstrated the need for improved quality control, including better use of technology to enhance the quality control on loan originations. FHFA has been working hard towards that end.

Earlier this year, I committed that the Enterprises would take two significant steps regarding reps and warrants.

First, all rep and warrant claims to be made on pre-conservatorship loans need to be made by the end of this year. It is time for us to wrap up all open issues dealing with that period and move on.

Fannie Mae and Freddie Mac are on track with regard to completing their repurchase requests on pre-conservatorship loans by year-end. I am pleased with the mutual cooperation by many counterparties to resolve these challenging business matters in a professional way. I look forward to a speedy resolution of remaining claims in the coming months.

Second, since the start of this year for all new production, the rep and warrant model has been changed to rely upon the quality control review process taking place near the time of purchase rather than waiting until much later, such as when a mortgage becomes delinquent. The period for which the rep and warrants remain active, except for limited issues such as fraud, is now limited to three years for performing loans.

For the future, we will continue to refine and improve upon the rep and warrant framework. Important strides have been implemented this year. But there is still a learning process going on, and further improvements should emerge over time. In particular, I anticipate improved data systems and technological developments to contribute to faster and more reliable loan reviews that can lead to further rep and warrant relief in the future.

Still, this will take time. I hope that constructive dialogue between you, as mortgage originators, and Fannie Mae, Freddie Mac, and FHFA will lead to further enhancements that result in both improved mortgage origination systems and greater confidence that loans sold into the secondary market will not come back someday due to origination defects.

Another area of progress in wrapping up the past is resolving securities law claims on private-label MBS. These issues are somewhat analogous to the rep and warrant issue and they too need to be resolved. FHFA has now settled four of the eighteen outstanding lawsuits in this area and we hope to build upon those cases to resolve the pending ones. An expeditious resolution of these remaining claims will allow the conservatorships and the companies involved to put these past problems behind them and devote their energies and resources to improving the housing finance system for the future.

Conclusion

As policymakers think about the future, I would note that our current housing finance system has its roots in the Great Depression. As a Nation we should look at this as an opportunity to build a new housing finance system not for the next few years, but a restructuring that could last for decades. This effort should not be about considering just what Fannie Mae and Freddie Mac do in the housing finance market, but considering the entire market, including the Federal Housing Administration and other government programs that support housing finance.

Long-term, continued operation in a government-run conservatorship is not sustainable because each company lacks capital, cannot rebuild its capital base, and is operating on a remaining, finite line of capital from taxpayers. Furthermore, a taxpayer-backed conservatorship provides a significant subsidy to the mortgage market that crowds out private capital and underprices risk in the market. It also places long-term decision making in the hands of a government agency, decisions that should be made by private sector businesses based on reasonable returns on private capital.

At some point, lawmakers will need to decide on the appropriateness and level of a government credit subsidy for housing. Such a decision should include whether a government-owned corporation should undertake some or all of the business activities of Fannie Mae and Freddie Mac, or whether some or all of those functions should be repositioned in the private sector.

In the meantime, FHFA will continue to carry out its mandate as conservator, accelerating its efforts to ease the transition to a post-conservatorship market ultimately defined by lawmakers. And the employees at Fannie Mae and Freddie Mac will continue to ensure their companies bring stability and liquidity to the market while they contribute directly to building towards that post-conservatorship market.